S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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| In the matter of the application of<br>**Consumers Energy Company** for<br>authority to reconcile electric<br>revenue pursuant to Pilot Revenue<br>Decoupling Mechanism and for<br>other relief | )<br>)<br>)<br>)<br>)<br>) | Case No. U-16566 |

**NOTICE OF PROPOSAL FOR DECISION**

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on February 3, 2012.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before February 24, 2012, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before March 9, 2012. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Dennis W. Mack

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Dennis W. Mack
Administrative Law Judge

February 3, 2012
Lansing, Michigan

**STATE OF MICHIGAN**

**MICHIGAN ADMINISTRATIVE HEARING SYSTEM**

**FOR THE MICHIGAN PUBLIC SERVICE COMMISSION**

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| In the matter of the application of **Consumers Energy Company** for authority to reconcile electric revenue pursuant to Pilot Revenue Decoupling Mechanism and for other relief | ) ) ) ) ) ) | Case No. U-16566 |

## PROPOSAL FOR DECISION

## I.

## PROCEDURAL HISTORY

The Michigan Public Service Commission (Commission) entered an Order on November 2, 2009, in Case No. U-15645 that, *inter alia*, adopted a pilot revenue decoupling mechanism (PRDM) applicable to the retail electric utility business of Consumers Energy Company (Consumers Energy). Under that Order, the PRDM became effective on December 1, 2009, and Consumers Energy was directed to file annual reconciliations no later than March 1 of each year. On March 1, 2011, Consumers Energy filed the Application at issue in this case, in which it seeks to reconcile the PRDM for the period of December 1, 2009 through November 30, 2010. Specifically, Consumers Energy seeks authorization to adjust its existing retail electric rates in order to recover $26,915,000, plus interest, in additional revenue.

Pursuant to due notice, a pre-hearing conference was conducted on April 14, 2011, during which Consumers Energy and Commission Staff appeared. During that pre-hearing conference petitions to intervene filed by the Attorney General, Association of Businesses Advocating Tariff Equity (ABATE), and Energy Michigan, Inc., were granted. 1 TR 5. A schedule was established during the pre-hearing, which was subsequently amended at the request of the parties, for the processing of this case.

The hearing in this matter was conducted on August 18, 2011. During the hearing, Consumers Energy entered the testimony of the following employees: James R. Anderson, Executive Manager of Electric Asset Management; Teri L. Van Sumeren, Manager of Energy Efficient Solutions; and Phillip E. Clifford, Senior Rate Analyst. In addition, Consumers Energy entered rebuttal testimony of Mr. Anderson and Mr. Clifford, along with Exhibits A-1 through A-17, ad seriatim. The Attorney General entered the testimony of Sebastian Coppola, President of Corporate Analytics, Inc., and Exhibits AG-1 through AG-6, ad seriatim. ABATE entered the testimony of James Selecky, Managing Principal of Brubaker & Associates, Inc. Energy Michigan entered the testimony of Alexander J. Zakem, a Consultant in the fields of Merchant Energy and Utility Regulation, and Exhibits EM-1 through EM-4, ad seriatim. Staff entered the testimony of: Katie J. Morgan, an Economic Analyst in the Energy Efficiency Section of the Electric Reliability Division; Nicholas M. Revere, an Economic Analyst in the Rates and Tariff Section of the Regulated Energy Division; and Dolores A. Midkiff-Powell, the Audit Manager of the Act 304 Reconciliation Section of the Regulated Energy Division. Staff also entered Exhibits S-1 through S-6, ad seriatim. Under a schedule established during the pre-hearing conference, all of the parties filed post-hearing Briefs and Reply Briefs.

## II.

## REVENUE DECOUPLING MECHANISM

In general, revenue decoupling was addressed by the Commission in Case No. U-15805:

> The Commission agrees with the Staff and others that Consumers' renewed request for approval of a revenue decoupling mechanism is beyond the scope of this proceeding. As the ALJ correctly pointed out, the Commission has found that the proper forum for addressing decoupling is in a general rate case proceeding. Nevertheless, the Commission recognizes the importance of decoupling as the primary means to remove the utility disincentive to promoting energy optimization and recognizes the urgency in implementing decoupling to support Consumers' EOPs [energy optimization plans]. Therefore, the Commission will address decoupling for both gas and electric service in the company's respective general rate cases.[1]

In its next electric rate case, Consumers Energy proposed a "revised decoupling mechanism (RDM), which would be applicable to all residential, secondary and primary customers." Case No. U-15645, November 2, 2009 Order (November 2 Order), p 48. After considering and rejecting challenges to a decoupling mechanism, including those advanced by the Intervenors in this case, the Commission held:

> A decoupling mechanism is typically created as a solution to further the public policy objectives of assisting customers to use energy more efficiently and reduce the utility's reliance on certain existing fuel sources, while reducing overall costs. The principal purpose of decoupling is to transform the current regulatory paradigm that gives a utility a strong incentive to sell as much electricity as possible, without regard to the negative effects upon overall costs and individual customer bills. Decoupling can be utilized to manage changes in electricity sales attributable to updated building codes, expanded energy efficiency programs (including federal and state weatherization programs), upgrades in appliance efficiency, and other similar demand side policies. Decoupling is a ratemaking mechanism that removes

[1] In the matter, on the Commission's own motion, regarding the regulatory reviews, revisions, determinations, and/or approvals necessary for Consumers Energy Company to fully comply with Public Acts 286 and 295 of 2008. Case Nos. U-15805 and U-15889, May 26, 2009 Order, p 31.

> the link between energy sales, or throughput, and the utility's non-fuel revenues. With decoupling, differences between projected and actual sales, and the associated differences in the utility's revenues, are reconciled periodically. A well-crafted decoupling mechanism will likely mean that changes in revenue resulting from changes in consumption will no longer cause a utility to file a general rate case. Rather, a utility's need to file a general rate case will be driven by changes in the utility's underlying costs.
> November 2 Order, pp 51-52.

Having enumerated the benefits of a well-crafted decoupling mechanism that balanced "the interests of customers and the utility," the Commission authorized a PRDM, effective December 1, 2009, contingent on Consumers Energy:

1. meeting certain reporting requirements;
2. exceeding the benchmarks for the energy optimization program established pursuant to Public Act 295 of 2008;
3. committing to provide enhanced energy efficiency programs and demand side resources that enable all customers classes to effectively manage rising energy costs, including proposals to accomplish this in the next filed rate case; and
4. surpassing minimum reliability standards under rule and law.

*Id*., pp 52-53.

As for the reconciliation of the decoupled revenue, the Commission held:

> The pilot decoupling mechanism shall be symmetrical and shall reconcile non-fuel/non-purchase power revenue. In the utility's annual decoupling mechanism reconciliation proceeding, which shall be filed on or before March 1 of each year, Consumers' actual (non-weather adjusted) sales per customer during the 12-month period from December 1 to November 30 will be compared with the base sales per customer level amount established in this case [U-15645]. Any sales per customer variance will be multiplied by the non-fuel revenue (distribution charge) per kWh in order to obtain the non-fuel revenue variance per customer. Then, multiply the non-fuel revenue variance per customer by the average monthly number of customers established in this rate case in order to obtain the resulting nonfuel revenue variance. Any overage or shortfall shall be credited or surcharged on a per kWh basis going forward. A deadband is not included in the pilot mechanism. The application of the mechanism upon specific customer groups, customer classes, or a combination thereof, will be determined in the reconciliation proceeding.
> *Id*., p 53

The Commission directed the reconciliation of the PRDM be conducted as a contested case, and set forth the information required to be provided in the Application:

> The utility's annual March 1 filing shall include all testimony and exhibits necessary for the reconciliation proceeding, including how the mechanism will apply to customer groups, customer classes, or a combination thereof and shall be simultaneously served on all parties to its most recent general rate case proceeding. Specifically, in each annual decoupling reconciliation application, Consumers shall file data on its average per customer sales levels. In the event Consumers has filed a new rate case and self-implemented new rates in the 12-month period, Consumers shall include a very detailed proposal with specific explanation as to how self-implementation fits with the decoupling mechanism and proposed reconciliation.
> *Id*., p 54.

Finally, the Commission held:

> In future proceedings, the Commission encourages parties to file comments or proposals to address the regulatory lag involved in annual reconciliations, exclusion of revenues (sales) attributable to severe outages or other similar circumstances, risk assessment for both the utility and customers, and recommendations for adjustment and evaluation of the pilot.
> *Id*.

On January 22, 2010, Consumers Energy filed another rate case in which the Commission addressed the PRDM:

> The PRDM runs from December 1, 2009 to November 30, 2010. November 2 order, p. 53. There is very little on this record that allows the Commission any meaningful review of whether Consumers has complied with the Commission's conditions over the course of the past year or not. In particular, the Staff offers no feedback on this issue, and Consumers' commitments are prospective and not well fleshed out. The Commission notes that Consumers indicates that it is meeting existing reliability standards; this is not the condition placed on the company by the Commission. However, the Commission does not intend to terminate the PRDM in this proceeding before either the Commission or the stakeholders have had the chance to gain sufficient experience with the mechanism to make corrections to it that make sense. The Commission will have the opportunity in Case No. U-16412 to review the amended EOP for compliance with these conditions; and will be addressing compliance issues in the first PRDM reconciliation due to be filed March 1, 2011. The conditions stated in

> the November 2 order remain in place.
> Case No U-16191, November 4, 2011 Order, p 55.

In response to arguments in Case No U-16191 that the PRDM should be altered, the Commission held:

> This is a pilot program. The Commission agrees with the Staff and finds that, since this rate case was filed upon the heels of the last rate case such that the PRDM has not been allowed to operate for a full year, it would not be appropriate to adopt any changes to the PRDM in this proceeding. However, the Commission can see that there are several issues that deserve attention with respect to continuance of the PRDM. To that end, the Commission directs the Staff to convene a technical conference to be held before January 15, 2011. The technical conference should bring together all stakeholders and parties interested in the electric PRDMs that are currently in operation. Issues for exploration should include weather normalization, accounting/booking issues, the regulatory lag involved in annual reconciliations, selection of a cap on reconciliation surcharges, updating sales forecasts on an annual basis, exclusion of revenues (sales) attributable to severe outages or other similar circumstances, exclusion of particular customer groups, risk assessment for both the utility and customers, the success of the pilots thus far in facilitating utility provision of increased energy efficiency programs, whether balances should carry over from year to year, and other recommendations for adjustment and evaluation of the pilot programs. No later than February 15, 2011, the Staff shall submit to the Commission a report on the conference, summarizing the positions taken, and any consensus that developed with regard to the issues. At the first reconciliation, the Commission will explore possible changes to Consumers' PRDM in light of lessons learned from the first year of real world experience. In the meantime, the Commission authorizes Consumers to continue the existing PRDM from December 1, 2010 to November 30, 2011, with the next reconciliation application due March 1, 2012.
> *Id*., pp 58-59.

## A. <u>Authority to Approve Decoupling</u>

Before turning to the relative merits of the arguments of the other parties on what methodology should be employed in determining the revenue variance under the PRDM and its application to customers, it is necessary to address a legal issue. Both the Attorney General and ABATE contend the Commission lacks statutory authority to implement a

PRDM for electric utilities. This contention is based on two statutory provisions. The first allows natural gas utilities to decouple rates. MCL 460.1089(6). The second directs the Commission to issue a report to the Legislature "on the potential rate impacts on all classes of customers if the electric providers whose rates are regulated by the commission decouple rates." MCL 460.1097(4). Absent the express statutory authority provided for in MCL 460.1089(6), the Attorney General and ABATE contend the Commission cannot approve a PRDM for electric utilities. In its November 2 Order, the Commission rejected the argument that it lacks authority to authorize rate decoupling for electric utilities:

> Furthermore, contrary to the arguments made by ABATE and the Attorney General, the Commission finds it has full authority over rate design and regulatory mechanisms, such as decoupling. The Commission has broad ratemaking authority over all aspects of a utility's rates, and nothing in Act 295 indicates that the Commission lacks authority or precludes the Commission from utilizing trackers or a decoupling mechanism. In light of this, the Commission finds it is timely to put a decoupling mechanism in place, so that it might fully assess the benefits and consequences of a specific decoupling mechanism with real world experience.
> Case No. U-15645, November 2, 2009 Order, p 52

Subsequently, the Commission reiterated its holding in denying the petitions for rehearing filed by the Attorney General and ABATE. Case No. U-15645, January 25, 2010 Order, p 11. Consistent with these holdings, the same arguments advanced by the Attorney General and ABATE in this proceeding are rejected.

B. <u>Consumers Energy's Application</u>

Consumers Energy asserts that under the rates authorized in the November 4, 2011, Order in Case No. U-16191, during the reconciliation period sales level variations among customer classes resulted in a $26,915,000 revenue deficiency.

2 TR 185. The revenue deficiency was determined under a methodology identified as Average Use by Customer, which Mr. Clifford testified to:

> [C]ompare actual (non-weather adjusted) sales per customer during the 12-month period from December 1 to November 30 to the base sales per customer level amount used to establish base rates for each customer class. Any sales per customer variance was then to be multiplied by the non-fuel revenue per kWh in order to obtain the non-fuel revenue variance per customer. To determine total revenues, the Company is to multiply the non-fuel revenue variance per customer by the average monthly number of customers used to establish base rates in each rate case for each customer class in order to obtain the resulting nonfuel revenue variance. Any overage or shortfall is credited or surcharged on a per kWh basis going forward.
> TR 2, p 162.

Because Consumers Energy's base rate changed during the reconciliation period, as a result of its self-implementation in Case U-16191 and the Commission's subsequent Order in that case, calculations for various time periods (December 2009-June 2010, July 2010, August 2010, and September 2010-November 2010) during the reconciliation period were utilized. [2] The calculations for those time periods, along with the total for the entire reconciliation period, broken down by rate class are depicted on Exhibit A-8. Under the Average Use by Customer methodology, Consumers Energy calculated a $26,915,000 revenue shortfall for the reconciliation period. Exhibit A-8, p 5; 2 TR 163.

The November 2 Order left for this proceeding "[t]he application of the mechanism upon specific customer groups, customer classes, or a combination thereof, will be determined in the reconciliation proceeding." Case No. U-15645, November 2, 2009 Order, p 53. Under this provision, Consumers Energy proposes two methods to recover the decoupled revenue. The first is identified as Method A and entails the over/under recovery of revenue by rate class under an allocation of forecasted electricity sales for 2012 based on a volumetric surcharge per kWh. Exhibit A-8. Method A results in a $7,513,000 refund to residential rate class customers, and surcharges of $3,915,000 to secondary rate class and $30,521,000 to primary rate class customers. Exhibit A-9; 2 TR 164. The second is identified as Method B and consists of an allocation to all customers based on their respective classes pro rata share of Consumers Energy's overall revenue requirements set in Case No. U-15645. Under that methodology a surcharge of $13,821,000 to residential customers, $6,049,000 to secondary customers, and $7,181,000 to primary customers would be authorized. [3] Exhibit A-10; 2 TR 166. Under either Method A or Method B, refunds or charges would be applied over a 12-month period, and include interest set by the Company's short-term interest rate. Exhibit A-10, 2 TR, p 164.

The rate classes under both Method A and Method B, and attendant refund or surcharge, consists of all secondary full service and retail open access (ROA) customers, and all primary full service and ROA customers. Mr. Clifford testified the combination is premised on the increase in ROA participation from what was projected in Case No. U-15645, approximately 4.7% of total sales, and the actual level, approximately 11% of total sales, as of the November 2010 end of PRDM reconciliation period. 2 TR 165. Mr. Clifford testified the combination is necessary because the impacts of certain factors, such as energy efficiency improvements and conservation, cannot be distinguished between ROA customers and secondary/primary rate classes. 2 TR 166. In addition, the

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[2] Consumers Energy self-implemented a rate increase of $150,000,000 on July 22, 2010 in Case No. U-16191. In an Order entered on November 4, 2010, the Commission approved an increase of $147,749,000. The difference was reconciled in an Order entered on June 16, 2011 in Case No. U-16546.

[3] The difference in the $27,051,000 collected under this method and the $26,915,000 sought in the Application is interest.

combination distributes the responsibility for revenue variances among the largest number of customers. *Id*.

C. Contingencies

The November 2 Order enumerated four standards and/or requirements (Contingencies) that Consumers Energy had to satisfy. Case No. U-15645, November 2, 2009 Order, pp 52-53. There is no dispute three of the Contingencies were satisfied: meeting certain reporting requirements; exceeding benchmarks for its Energy Optimization Program; committing to programs and resources that enable its customers to manage energy costs. However, Consumers Energy acknowledges it failed to comply with the Contingency requiring it to surpass minimum reliability standards under rule and law. In this regard, in 2009 Consumers Energy satisfied 9 of the 11 Service Quality and Reliability Standards (SQR Standards) established by the Commission. Exhibit A-1. The two that were not satisfied were answering customer calls in less than 90 seconds, which took 141 seconds, and restoring service for 90% or more of its customers in 8 hours or less under normal conditions (Service Restoration Factor), which was done for 86.5% of the Company's customers. *Id*. In 2010 Consumers Energy satisfied all but the Service Restoration Factor, which dropped to 85.5%. *Id*.

Consumers Energy argues that because the catastrophic conditions level is so high under the SQR Standards, certain storms that cause massive outages do not reach that level. 2 TR 139. Accordingly, the outages from storms at the upper end of the normal scale, which would be quantified as catastrophic under other industry standards, skews the Service Restoration Factor under the SQR Standards. Exhibit A-2; 2 TR 139. Leaving aside the merits of this argument, the purpose of this proceeding is not to determine whether the definition of normal conditions and catastrophic conditions in the SQR Standards are appropriate. [4] Rather, the sole issue is whether Consumers Energy satisfied the Contingency by surpassing minimum reliability standards established under rule and law, i.e. the SQR Standards. The evidence on this record indicates that in 2009 Consumers Energy failed to satisfy two of those standards, and in 2010 it failed to satisfy one standard. The question is what, if any, legal effect attach to the non-compliance with the SQR Standards concerning answering customer's calls in 2009, and restoring service under normal conditions in 2009 and 2010.

Consumers Energy contends that its substantial compliance with the Contingencies are, for the purposes of this proceeding, sufficient for approval of its proposed reconciliation. In support, it cites to the Commission's holding that "concomitant with the initial reconciliation, [it] intends to approve operation of the decoupling mechanism for the initial year, with continuation being subject to review as described in the [November 2 Order]." Case No U-15645, January 25, 2010 Order, p 10. [5] To Consumers Energy, this holding indicates compliance with the Contingencies is only relevant going forward, a position Staff also takes. 2 TR 216. Conversely, both the Attorney General and ABATE contend the non-compliance with the SQR Standards are relevant, and require sanction. ABATE argues the appropriate sanction is the rejection of the surcharges Consumers Energy is seeking. 2 TR 89-91. To the Attorney General, the sanction is either a rejection of the surcharges unless and until Consumers Energy fully complies with the

[4] Mr. Anderson testified to the steps Consumers has implemented to increase its service restoration factor. 2 TR 140.
[5] The January 25, 2010 Order grants Consumers' petition for rearing on two decoupling issues.

SQR Standards, or a reduction of the surcharges commensurate with its non-compliance. 2 TR 54-55. In regards to the latter, Mr. Coppola testified the Company did not comply with 9% of the SQR Standards, i.e. 1 of the 11. Since those Standards constitute 25% of the contingencies, Mr. Coppola arrives at a non-compliance factor of 2.3%, which is 1/4 of 9%. 2 TR 55. Mr. Coppola proposes deducting $618,000, which equates to 2.3% of the $26,900,000 decoupled revenue sought, as a disallowance penalty. 2 TR 55.

Both the Attorney General and ABATE argue that Consumers Energy was obligated to fully comply with the four Contingencies enumerated in the November 2 Order, and that requirement was neither invalidated nor modified in the January 25, 2010 Order. However, by its terms, the November 2 Order does not provide a basis for either of the sanctions the Attorney General and ABATE seek. Rather, the four Contingencies are termed part of the balancing of the interests of customers and the utility, which the Commission deemed an important consideration in creating the PRDM. Case No. U-15645, November 2, 2010 Order, p 52. That language cannot be reasonably construed as allowing termination of the PRDM, or imposing a disallowance penalty under a formula that attempts to quantify the failure to comply with 1 of 11 SQR Standards. More importantly, consistent with the argument of Consumers Energy and Staff, in the January 25, 2010 Order, the Commission expressly rejected imposing any sanctions for non-compliance of the four Contingencies in the initial year of the PRDM. Therefore, the two instances of non-compliance with the SQR Standards in 2009, and one instance in 2010, have no legal significance in this proceeding.

## III.

## POSITIONS OF THE OTHER PARTIES ON THE PRDM

A. Staff

Staff rejects the Average Use by Customer methodology, and instead advocates approval of a methodology termed Actual Exposure, which produces results ranging from a $20,100,000 surcharge to a $3,700,000 rebate. The Actual Exposure methodology considers three variables: 1) customer groupings; 2) treatment of ROA customers; and 3) the start date for non-fuel proration under Case No. U-16191. Utilizing those variables, the PRDMs advanced by Staff are:

1. Customers are grouped by rate schedule, except for the combination of Full Service and ROA customers to ascertain changes in average use per customer, with a weighted average nonfuel rate for the combined ROA and Full Service grouping. The Company's self-implementation date in Case No. U-16191, July 22, 2010, is utilized for non-fuel rates. This methodology results in a $1,600,000 refund. Exhibit S-3.

2. Customers are also grouped by rate schedule, and Full Service and ROA customers are also combined, but the date of the Commission's Final Order in Case No. U-16191, November 2, 2010, is used for the nonfuel rate. This methodology results in a refund of $200,000. Exhibit S-4.

3. Customers are grouped by rate class, and Full Service and ROA customers are also combined, and the U-16191 self-implementation date is used for non-fuel rate proration. This methodology results in a surcharge of $15,900,000. Exhibit S-6.

4. Customers are grouped by rate schedule, but ROA customers are separate, as are power supply and distribution rates. The rates are applied to the difference between actual sales and a baseline, and the November 2, 2010 date is used for non-fuel proration. The result is a surcharge of $20,100,000. Exhibit S-5.

5. Customers are grouped by rate schedule, ROA and Full Service customers are combined, and the November 2, 2010 date is used. However, the power supply decoupling amount for General Service Primary Demand customers ($22,900,000) is zeroed out. Under this methodology, a $3,700,000 refund results. Exhibit S-5.

Staff seeks the adoption of the Item 5 PRDM based on its contention that it comports with the purpose of the November 2 Order. In addition, Staff contends that PRDM ensures just and reasonable rates by removing all effects of full-service customers migrating to choice. 2 TR 231, 276-277. In the alternative, if the Commission decides to utilize the Average Use Customer methodology advanced by Consumers Energy, Staff seeks adoption of the variables set forth in Item 2: group customers by rate schedule, combine ROA with Full Service, and a U-16191 non-fuel proration start date of November 2, 2010, which results in a $200,000 refund. 2 TR 230; Exhibit S-4.

The Actual Exposure methodology begins with the premise that power supply and distribution revenues must be separated, with ROA customers included in their proper rate class. 2 TR 276; Exhibit S-2. In regards to the former, Staff sought to calculate the difference between power supply revenue anticipated in the most recent rate case and actual revenue. Ms. Midkiff-Powell testified the power supply decoupling amount for General Service Primary Demand customers was zeroed out because:

> The increase in ROA sales for GPD customers exceeded the decrease in full service, indicating the decrease was due to the choice migration. Since these customers were now ROA, instead of full service, Staff did not allocate any of the power supply decoupling amount to those customers. ROA customers do not pay for the power supply cost since these customers receive their power from an alternative electric supplier and not the Company.
> 2 TR 276

While Staff's methodologies remove ROA from the power supply calculation, the distribution calculation includes both full-service and choice customers on total rate schedule amounts, which was multiplied by the change in sales over the reconciliation period. 2 TR 231; Exhibit S-5.

In essence, the difference between Staff's position and Consumer Energy's position, i.e. a $3,700,000 refund versus a $26,915,000 surcharge, is the removal from the PRDM calculation the effects of full-service customers migrating to choice. Ms. Midkiff-Powell testified this step is consistent with the Commission's holding that:

> The principal purpose of decoupling is to transform the current regulatory paradigm that gives a utility a strong incentive to sell as much electricity as possible, without regard to the negative effects upon overall costs and individual customer bills. Decoupling can be utilized to manage changes in electricity sales attributable to updated building codes, expanded energy efficiency programs (including federal and state weatherization programs), upgrades in appliance efficiency, and other similar demand side policies.
> Case No. U-15645, November 2, 2009 Order, p 51-52.

In addition, Mr. Revere testified on this point:

> The change in sales for the full service rates was adjusted by the amount of the change in choice sales in order to exclude the effects of choice migration for the power supply portion, as shown on Exhibit S-5, Schedule D1. The distribution calculation was carried out on the total rate schedule amounts, so no such adjustment was necessary, as shown on Exhibit S-5, Schedule D2. For rate schedule GPD, the change in choice sales seemed to correspond quite closely to the change in full-service sales, leading Staff to the conclusion that the change was due mainly to customers moving from full-service to choice. As a result, Staff zeroed out the power supply decoupling amount for this rate schedule. *** The calculations presented in Exhibit S-5 result in a surcharge for distribution, positive or negative, which would apply to both full-service and choice customers. The calculations presented in Exhibit S-5 also result in a surcharge for power supply, positive or negative, which would apply only to full-service customers.
> 2 TR 231-232

B. <u>The Attorney General</u>

The Attorney General, through the testimony of Mr. Coppola, agrees with Consumers Energy's contention that its revenue shortfall during the reconciliation period was $26,915,000. 2 TR 55. However, Mr. Coppola took issue with the PRDM because it excludes sales to customer groups that did not participate in Energy Optimization

Programs. Mr. Coppola notes the November 2 Order did not expressly provide for the exclusion of any rate schedules or customers from the PRDM. 2 TR 56. Therefore, he recommends all rate schedule sales be included in future reconciliations, except sales that are unmetered or involve self-generation. 2 TR 57.

As for the allocation of the shortfall, Mr. Coppola agrees with Method A: a $7,513,000 refund to residential customers through a bill credit, and surcharges of $3,915,000 to secondary customers and $30,521,000 to primary customers collected over the 12-month reconciliation period. Conversely, he takes issue with Method B, which allocates all of the $26,915,000 revenue variance to residential, secondary, and primary rate classes based on the revenue requirements of each as established in Case No. U-15645. Mr. Coppola testified to the inherent inequality in Method B due to residential customers effectively subsidizing revenue shortfall caused by other rate classes. 2 TR 58. This is exemplified by the fact that under Method A, the Residential Rate Class receives a $7,500,000 rebate, but under Method B, would pay a $13,800,000 surcharge. Conversely, under Method A, the Primary Rate Class is responsible for a $30,500,000 shortfall, but under Method B, would only be subject to a $7,200,000 surcharge. Along the same lines, Mr. Coppola also takes issue with the customer grouping utilized in the allocation method in Consumers Energy's PRDM because it shifts costs from bundled service customers to ROA customers. To rectify this situation he proposes the separation of the bundled service rate class from the ROA rate class, and the following allocation under Method A: refunds of $7,512,700 to Residential Class, and $51,000 to Primary ROA Service; surcharges of $3,757,500 to Secondary Bundled Service, $179,000,300 to Secondary ROA Service, and $30,583,100 to Primary Bundled Service. Exhibit AG-4 &

AG-5.

In response to the provision in the November 2 Order seeking input on the pilot program, Mr. Coppola recommends it be discontinued because the revenue loss is from choice migration, as opposed to decreased sales due to energy optimization. 2 TR 61, 65-66. [6] In the event the Commission decides to maintain the program, Mr. Coppola proposes these changes:

1. Weather normalization of actual usage.
2. Exclusion of industrial customers.
3. Clarification of revenues to be included.
4. Suspension of the RDM during self-implementation of rate increases.
5. Allocation of surcharges or refunds to rate classes.
6. Limitation of annual reconciliations.
7. ROE adjustment for business risk reduction.

Contrary to Item 1, the November 2 Order required use of actual, as opposed to weather adjusted, sales per customer. The ultimate disposition of this case will necessarily address the advisability of Items 2, 3, and 5. While Mr. Coppola testified in some detail about the other three proposed changes to the PRDM (2 TR 66-75), none of the other parties took a position on them through testimony or briefs. Thus they are noted for the Commission's consideration.

C. ABATE

Similar to Staff, ABATE contends, through the testimony of Mr. Selecky, that the revenue shortfall was the result of the migration of customers from bundled service to ROA. In support, Mr. Selecky notes that during the reconciliation period total system usage

[6] In addition to the policy basis for discontinuing the program, Mr. Coppola makes a legal argument that under MCL 460.1097(4) revenue decoupling is not authorized for electric utilities. 2 TR 61-62. That legal argument is addressed, and rejected, above.

increased 430,938 MWh over baseline usage. 2 TR 92. To further buttress this contention, Mr. Selecky notes the 1,810,000 MWh reductions in primary bundled usage "closely approximates" the 2,190,000 MWh increase in ROA usage. *Id*. Tying the usage variations together, Mr. Selecky notes that under Consumers Energy's proposed PRDM:

> [T]he non-fuel rate for primary bundled customers is approximately 2.9¢/kWh, which is significantly higher than the non-fuel rate for primary ROA customers of 0.8¢/kWh or 0.5¢/kWh. This variation in non-fuel rates means that the revenue shortfall resulting from the migration of customers away from primary bundled service is much greater than the revenue surplus generated by the increase in primary ROA usage, resulting in a large class revenue shortfall despite the fact that the increase in primary ROA usage closely tracks the reduction in primary bundled usage over the reconciliation period. Therefore, the migration of primary customers to ROA creates a large revenue shortfall of $30.5 million for the primary class that is largely unrelated to the Company's energy efficiency efforts.
> 2 TR 93

Accordingly, Mr. Selecky states the PRDM should be denied because it does not rectify revenue shortfalls due to energy efficiency. 2 TR 94.

In the event the Commission decides to authorize a PRDM, Mr. Selecky testified the appropriate measure is Method B, which allocates revenue shortfall to customer classes. 2 TR 96. The basis for this opinion is the perceived inequity in Method A, i.e. penalizing primary customers with surcharges merely because they elected to migrate to ROA. *Id*. Mr. Selecky also favors Method B because it recognizes the benefit of migration to the remaining customers in the form of reduced costs, such as dispatching high-cost generating units or purchasing capacity during peak periods. *Id*.

D. Energy Michigan

Mr. Zakem, on behalf of Energy Michigan, identified three factors that the PRDM should entail. The first is predicated on the principle that the purpose of the PRDM is to recover fixed costs irrespective of actual sales. Since full service customers receive both power supply and distribution, they should be responsible for the charges stemming from, or credits arising out of, these functions. Conversely, since ROA customers only receive distribution, they should be charged or credited only for that function. 2 TR 112. Obviously, this requires separation of power supply and distribution revenues, something Mr. Zakem contends Consumers Energy failed to do in this case, but indicated it would when advocating the implementation of a PRDM in Case No. U-15645. 2 TR 116-117. Accordingly, Mr. Zakem contends the Commission should establish a PRDM that distinguishes between Full Service and ROA customers. 2 TR 122.

The second factor Mr. Zakem seeks to have included in the PRDM is application of any credits or surcharges on a company-wide basis, as opposed to rate class basis. In this regard, he testified:

> The fundamental, underlying reason is that the "fixed" costs that an RDM is intended to recover (or refund) are *not in fact "fixed" for individual rate classes*. Rather, such costs are fixed for the company in total, and then are *allocated* to rate classes by the *relative, proportional* energy use characteristics of each class, such as proportion of total sales or proportion of total peak demand. The great majority of the fixed costs represent facilities, such as generation plants and distribution lines and equipment, that are used jointly by all rate classes at different times, and so are joint economic costs that must be allocated by some reasonable, but not unique, method. The methods of allocation have been established by Michigan law and Commission past orders, and are based primarily on energy use characteristics.
>
> Therefore, if the energy use characteristics of a rate class change, then the *proportion* of total costs for which the rate class will be *deemed responsible* will also change. To assume that the class will be responsible for the *same* dollar share of total company fixed costs *regardless of the amount of class sales* is contrary to the concept of allocation of fixed costs, which is fairly straightforward arithmetic.
> 2 TR 113-114 (emphasis in original).

Mr. Zakem notes Consumers Energy's proposed PRDM is based on customer class, which should be rejected because his modeling indicates it fails to reflect class rate changes that occur in a rate case. 2 TR 114. The proper method involves calculation of total PRDM revenue to be recovered by rate class, which is then separated by power supply, attributable only to full service customers, and distribution, attributable to all customers, i.e. both full service and ROA. 2 TR 115.

The final factor Mr. Zakem proposes is the sales variation upon which the PRDM is based should be limited to actual data. 2 TR 115-116. While acknowledging that using actual sales data appears to be axiomatic, Mr. Zakem notes that sales variation could be derived from modeling or the estimated effect of energy optimization on sales. In this case, Mr. Zakem testified it appears Consumers Energy utilized actual sales in formulating its PRDM, and thus it is unnecessary to adjust the calculation.

Consistent with the foregoing, Energy Michigan asserts the methodology proposed by Staff be adopted, albeit with company-wide application.

## IV.

## RECOMMENDED PRDM

In essence, this case comes down to a determination of the purpose of the PRDM under prior decisions of the Commission, particularly those entered in Case No. U-15645. Specifically, whether the PRDM should mitigate the loss of all non-fuel revenue, which is the effect of Actual Use by Customer proposal, or the loss of revenue due only to energy optimization programs, which is the effect of Staff's Actual Exposure proposal. Closely related to this dispute is the issue of whether the Commission established a specific methodology for the PRDM in Case No. U-15645, or, in the alternative, provided some degree of flexibility. In advocating for the former, Consumers Energy cites to the holding that "[t]he pilot decoupling mechanism shall be based upon Consumers' revised revenue decoupling mechanism as illustrated in revised Exhibit No. A-105, with modifications." Case No U-15645, November 2, 2009 Order, p 53. Consistent with this language, Consumers Energy argues the mechanism is established, rendering many of the issues in this case decided, and all that remains is the reconciliation. Staff contends the Commission did not adopt a specific methodology, but rather deferred the formulation of such specifics to this proceeding, which it notes is the first opportunity to review actual data. In addition, Staff notes the Commission created a pilot program, and encouraged the submission of recommendations regarding the program "in future proceedings…." *Id*., p 54.

By its terms, the November 2 Order created a basis upon which the PRDM was to be carried out, i.e. Exhibit A-105 in Case No. 15645, along with other controlling factors, such as the time-frame for the reconciliation period and various formulas. *Id*., p 53. However, this provision cannot be conflated to the level that Consumers Energy asserts based on the Order as a whole. For example, the November 2 Order expressly holds other considerations will be at issue in this case: "how the mechanism will apply to customer groups, customer classes, or a combination thereof…." *Id*., p 53. To that end, Consumers Energy was directed to file in the Application at issue in this case, testimony and exhibits concerning these issues, along with sales data and information concerning a rate case during the reconciliation period. *Id*., p 54. Along the same lines, the invitation to other parties to weigh in on the PRDM is also a clear indication the Commission did not create a rigid methodology. Finally, in a subsequent Order the Commission expressly held the methodology was subject to further review:

> While the November 2 order appears to be clear that the decoupling mechanism is a pilot program, and that the Commission intends to review several aspects of the program after the first year of real world experience, the Commission hereby clarifies that order to explain that, concomitant with the initial reconciliation, the Commission intends to approve operation of the decoupling mechanism for the initial year, with continuation being subject to review as described in the [November 2 Order, p 54].
> Case No. U-15645, January 25, 2010 Order, p 4.

Based on the foregoing, Consumers Energy's contention that the methodology underlying the PRDM was established in Case No. U-15645, in a manner that renders it inviolable in this proceeding, cannot be sustained. Rather, Staff's contention that this is the proper proceeding for the Commission to review, evaluate, and if warranted, modify the PRDM, is valid under the terms of the November 2 and January 25 Orders in Case No. U-15645.

Having determined the methodology is flexible, the inquiry now turns to whether the PRDM is a means to address variances for all non-fuel revenues, or only those resulting from energy optimization. Breaking the issue down further, Staff contends the PRDM should preclude any recovery of revenues lost as a result of choice migration. In this regard, Ms. Midkiff-Powell cites to this provision in the November 2 Order:

> The Commission agrees in concept with both Consumers and the Staff. A decoupling mechanism is typically created as a solution to further the public policy objectives of assisting customers to use energy more efficiently and reduce the utility's reliance on certain existing fuel sources, while reducing overall costs. The principal purpose of decoupling is to transform the current regulatory paradigm that gives a utility a strong incentive to sell as much electricity as possible, without regard to the negative effects upon overall costs and individual customer bills. Decoupling can be utilized to manage changes in electricity sales attributable to updated building codes, expanded energy efficiency programs (including federal and state weatherization

> programs), upgrades in appliance efficiency, and other similar demand side policies. Decoupling is a ratemaking mechanism that removes the link between energy sales, or throughput, and the utility's non-fuel revenues. With decoupling, differences between projected and actual sales, and the associated differences in the utility's revenues, are reconciled periodically. A well-crafted decoupling mechanism will likely mean that changes in revenue resulting from changes in consumption will no longer cause a utility to file a general rate case. Rather, a utility's need to file a general rate case will be driven by changes in the utility's underlying costs.
> Case No. U-15645, November 2, 2009 Order, pp 51-52

Mr. Clifford disagrees that any such limitation was imposed:

> The PRDM approved by the Commission clearly included the revenue impact associated with all nonfuel revenue loss, including the revenue loss associated with migration of customers from Full Service to ROA. In its November 2, 2009 order approving the PRDM in U-15645, the Commission specifically addressed the issue of Choice migration, when it terminated the Company's Electric Choice Incentive Mechanism ("ECIM"):
>
>> The Commission finds that the ECIM has become unnecessary in light of changes in circumstances since Consumers' last rate case. The effect of the tracker mechanisms adopted in this order, together with implementation of statutory restrictions on choice, is to mitigate much of the potential for revenue instability. Therefore the ECIM shall terminate on November 30, 2009, which is the end of the final period for reconciliation of the current ECIM. (page 58)
>
> It is clear from this order that the Commission believed the "tracker mechanisms," including the approved PRDM, would help mitigate the effects of migration to choice, and therefore terminated the ECIM. The ECIM had originally been put in place as a mechanism to address the volatility in sales revenue associated with migration to and from Electric Customer Choice. Unless the impact of the migration to Choice was included in the PRDM, little or no revenue stability could be anticipated from the approval of the decoupling mechanism.
> 2 TR 185

To ascertain the scope of the Commission's authorization of a PRDM, it is necessary to examine November 2 Order. In the underlying case Consumers Energy proposed two mechanisms, a dead-band based sales adjustment and a revised decoupling mechanism applicable to all residential, secondary, and primary customers. Case No. U-15645, November 2, 2009 Order, pgs. 47-48. Staff did not object to the dead-band mechanism, but offered as an alternative "an energy optimization (EO) lost revenue tracker." *Id*., p 47. Subsequently, both Consumers Energy and Staff sought approval of the revised decoupling mechanism, although Staff maintained its preference for the EO lost revenue tracker. *Id*., p 50. Ultimately, the Commission agreed "in concept with both Consumers and Staff" and found it "timely to put a decoupling mechanism in place…." *Id*., pp 51-52. In so doing, the Commission did not express any indication that the mechanism is limited to revenues associated with energy optimization. In fact, had it so intended the Commission would have adopted Staff's EO lost revenue tracker, which is effectively what Staff's Actual Exposure methodology constitutes. 2 TR 277. Finally, the November 2 Order served to terminate Consumers Energy's electric choice incentive mechanism, which protected the Company and its customers "from a significant variation in ROA sales levels as compared to those estimated in base sales rates." Case No. U-15645, November 2, 2009 Order, p 57. That step was taken, *inter alia*, based on "[t]he effect of the tracker mechanism adopted in this order…." *Id*., p 58. [7] Accordingly, the PRDM is intended to mitigate the loss of non-fuel revenues, including those attributable to choice migration.

Based on the foregoing, the Actual Exposure methodology advanced by Staff, and intended to remove the effects of choice migration from the PRDM, does not comport with the PRDM authorized in the November 2 Order.

Turning to Consumers Energy's proposed PRDM, the record supports the proration

[7] Had the electric choice incentive mechanism remained in effect during the PRDM reconciliation period, it would have resulted in a revenue shortfall of $43,000,000 without the 10% deadband reduction. Exhibit A-14; 2 TR 187.

of the non-fuel/non-purchase power rate for the periods before and after July 22, 2010, which is the date the electric rates were self-implemented in Case No. U-16191. While those rates were subsequently changed in the Commission's November 4, 2010 Order, the July 22 self-implemented rates had no effect on sales levels, which were the same set in Case No. U-15645, and the revenues collected between July and November 2010 were reconciled in Case No. U-16546. Using the reconciled rates, Consumers Energy properly calculated the average usage per customer revenues for each of its customer classes, along with the ultimate revenue shortfall for the reconciliation period: $26,915,000. Exhibit A-8. With the exception of a $63,000 interest amount computation error detected by Mr. Coppola in Exhibit A-10, which Mr. Clifford rectified in Exhibits A-16 and A-17, none of the parties challenged the calculations underlying Consumers Energy's proposed PRDM. Based on this record, the PRDM proposed by Consumers Energy fully comports with the Commission's authorization of a mechanism that determines a total revenue variance for the specified time period, including the specified components in the November 2 Order. *Id*., p 53.

This leaves the considerations the Commission expressly directed be addressed in this case: application of the PRDM to "customer groups, customer classes, or a combination thereof…." *Id*., p 54. As noted, two methods to allocate decoupled revenue to rate classes are under consideration: Method A, which is a mechanical allocation of calculated revenue in the form of a refund or collection to residential, secondary, or primary rate classes; and, Method B, which allocates the total net shortfall of decoupled revenue to the three rate classes based on their respective revenue requirements as established in Case No. U-15645. Under both Method A and Method B, ROA customers are grouped with either secondary or primary customers in order to determine the net amount of decoupled revenue to be collected or refunded to each rate class. 2 TR 165. Consumers Energy contends such a combination is necessary given the unexpected impact resulting from choice migration, along with the inability to effectively segregate sales impacts from other factors. [8] *Id*., at 166; Exhibits A-8, A-9 & A-10.

Staff seeks grouping of customers by rate class and the combination of full service and ROA customers. Exhibit S-4. However, this proposal does not distinguish between these customer groups in calculating average customer use. Further, if this grouping is utilized, it will result in a large disparity between the non-fuel rate for full service customers and ROA customers, which will, in turn, "dramatically lower the amount of calculated non-fuel revenue variance produced by the [PRDM], which does not reflect reality." 2 TR 184. Mr. Clifford also noted the proposed customer grouping is inconsistent with the November 2 Order because it effectively removes revenue impacts resulting from choice migration:

> In Exhibits S-3, S-4 and S-6, Staff witness Nicholas Revere combines the Secondary ROA revenue with the Secondary Full Service revenue, and the ROA Primary revenue with the Full Service Primary revenue, and then subtracts out the Base PSCR revenue. The resulting amount was then divided by the combined total Full Service and ROA sales, to derive a blended Full Service/ROA nonfuel rate. Then Staff applies this rate to the variance in Average Usage per customer for the combined ROA/Full Service classes. This approach effectively estimates and then removes the change in average use per customer associated with the migration to Choice. It thus impacts the determination of the over- or under-collection of nonfuel revenue because the variance in average usage between actual usage and rate case usage is lower if ROA load is combined with Full Service load. Staff's method basically ignores the ROA sales class for purposes of determining the variance in average use per customer change, then applies a weighted average nonfuel rate to this variance that factors in the nonfuel rate of ROA customers and Full Service customers.

[8] In Case No. U-15645 Consumers' rates were based, in part, on ROA constituting 4.7% of total sales. During the reconciliation period ROA constituted approximately 11% of total sales. 2 TR 165.

2 TR 186-187.

Because it is premised on the removal of the effects of choice migration from the PRDM, which was rejected under the analysis of its Actual Exposure methodology, Staff's proposed customer grouping under the Actual Use by Customer methodology cannot be accepted.

Energy Michigan's proposed customer grouping is a company-wide allocation, but with separate adjustments of revenue attributable to power supply and distribution, with ROA customers only being responsible for distribution costs. This proposal raises a host of problems. First, as noted by Consumers, rates and costs established in Case Nos. U-15645 and U-16191 were premised on estimated levels of full service and ROA load, but customers are able to switch between these categories. Energy Michigan's proposed segregation of power supply and distribution requires the formulation and application of a proration formula. Not only would this requirement be unnecessarily complicated, it equates to a customer-by-customer approach to ratemaking, which is entirely inconsistent with the traditional approach. Further, an ROA customer still has an effect on power supply because Consumers must, as a provider of last resort, be prepared for the possibility the customer returns to full service. Along the same lines, Consumers' regional generating capacity is a necessary predicate of ROA service. In other words, ROA would not be possible without Consumers' power supply capacity. Finally, the legal support Energy Michigan relies on, MCL 460.11(1), does not exclude ROA customers from the 50-25-25 allocation of production-related and transmission costs. Rather, they are in a customer class, i.e. secondary or primary, subject to the allocation. To accept Energy Michigan's assertion effectively requires ROA customers be grouped in their own customer class, and thus the costs enumerated in MCL 460.11(1) must be allocated to them under the 50-25-25 formula. For these reasons, Energy Michigan's proposed segregation of power supply and distributions costs, and allocation of distribution costs only to ROA customers cannot be accepted.

The Attorney General recommends adoption of Method A, but with the separation of ROA rate classes from full service rate classes. As with Energy Michigan's proposal, the Attorney General's modification of Method A raises a number of problems. First, a customer switching from full service to ROA at any point during the reconciliation period would avoid decoupling costs, while a customer doing the opposite would incur the cost. As Consumers Energy correctly notes in its Reply Brief, such a situation "sends a perverse price signal to customers that has nothing to do with an actual comparison of the cost of ROA service with Full Service." Reply Brief, pg. 5. For these reasons, the Attorney General's proposed customer grouping cannot be accepted.

## V.

## CONCLUSION

Based on the foregoing, the Commission has the authority to implement revenue decoupling for electric utilities. Consistent with that authority, the Commission authorized a PRDM for Consumers Energy for the period between December 1, 2001 and November 30, 2010. The Commission's authorization of the PRDM included a requirement that Consumers Energy meet or exceed four Contingencies. However, the fact that those Contingencies were not fully complied with in this case does not preclude recovery of decoupled revenue.

The Commission's authorization of a PRDM did not preclude, if warranted, application of a methodology other than Average Use by Customer if warranted. Therefore, the Actual Exposure methodology proposed by Staff is a proper consideration in this case. The Commission's authorization of PRDM was not limited to recovery of revenues associated with energy optimization. The Actual Exposure methodology does not factor revenues beyond those associated with energy optimization, including those associated with choice migration. Therefore, the Actual Exposure methodology is inconsistent with the Commission's authorization of a PRDM for Consumers Energy.

The Average Use by Customer methodology advanced by Consumers Energy utilizes the specific factors the Commission identified in its authorization of the PRDM, and results in a $26,915,000 revenue shortfall during the reconciliation period. There is no substantive evidence on this record that other factors should be included in the methodology. Therefore, Consumers Energy experienced a $26,915,000 revenue shortfall between December 1, 2009 and November 20, 2010, that it is authorized to recover under the PRDM, minus a computation error of the interest.

The application of the PRDM to customer groups must comply with the terms of the November 2 Order, including the requirement to mitigate impacts to sales, including those attributable to the unexpected level of movement of customers to ROA, and ensures an equitable allocation of revenue variances among rate classes. Based on this record, the application of the PRDM under Method A achieves those purposes. Therefore, consistent with Method A, customer groups should be all secondary full service and ROA customers combined in one group, and all primary full service and ROA customers should be combined in another group. Applying the PRDM accordingly, residential rate class customers are entitled to a $7,513,000 refund, while surcharges should be assessed for $3,915,000 to secondary rate class, and $30,521,000 to primary rate class customers, minus the appropriate adjustment for the computation error. Exhibits A-9, A-10, A-16, A-17; 2 TR 164, 200.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Dennis W. Mack

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Dennis W. Mack
Administrative Law Judge

February 3, 2012
Lansing, Michigan